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THE STRUCTURE OF JAPAN'S IMPORTS: CAUSES AND CONSEQUENCES

Summary

As Japan's still large external imbalances showed sharp declines in the late 1980s and last year, attention shifted toward the composition of Japan's trade. The opinion began to take hold among some analysts that simply selling more to Japan was not a sufficient goal if the products were relatively unsophisticated. This concern, which highlighted Japan's imports of manufactured goods, became politically more important. In addition, researchers who suspected that Japan's manufactured imports are unduly low started looking for reasons. Some of these experts pointed toward keiretsu (corporate groups) as a prime suspect. Other experts have disputed the finding that manufactured imports are unduly low and, thus, have questioned the alleged causes.

Keiretsu also are near the top of the agenda of the Structural Impediments Initiative, the U.S.-Japan dialogue that explores alleged structural deficiencies in each economy, particularly those that some officials see as contributing to the bilateral imbalance. Research concerning the level and the structure of Japan's manufactured imports appear to have influenced the SII talks by putting increased emphasis on keiretsu.

Public impressions to the contrary, the keiretsu debate -- and its discussion in the SII context -- have virtually nothing to do with the size of the trade imbalance between the United States and Japan. As U.S. trade officials admit, Japan's trade surplus with the United States is a result of the overall savings rates in both countries. At most, the questions surrounding keiretsu involve the composition of Japanese exports and imports. Recent data suggest that, on the import side at least, Japan's

trade structure continues to evolve in the direction advocated by American critics.

The Overall Context

Policymakers pay attention to U.S.-Japan trade for a number of reasons. The recent research by a variety of economists is relevant to some of these concerns but not others. Worry about the external imbalance between the United States and Japan typically focuses on the U.S. measure of the bilateral trade imbalance; this yardstick, however, involves a number of conceptual problems. (For descriptions of various measures and details of this argument, see JEI Report No. 15A, April 19, 1991.) Among other difficulties, the implied importance of a bilateral balance is misplaced. Even on the assumption that the equality of exports and imports is important, a worldwide balance in the accounts of both the United States and Japan would appear sufficient; this scenario, however, likely would mean Japan still would have a surplus with the United States. If the United States set itself the task of achieving a balance in trade with each of its partners with which it now runs a deficit, it probably would end up with a worldwide surplus and bruised feelings in dozens of capitals in the unlikely event of a successful effort.

Despite these problems, the U.S.-Japan trade imbalance has remained a focus. Since the 1970s the imbalance between the two nations has featured a consistent Japanese surplus, peaking at $52.1 billion in 1987, according to Ministry of Finance data. Japan's surplus with this country rose between 1985 and 1987 despite the appreciation of the yen against the dollar and did not dip below its 1985 level until 1990. The net reduction of 3.9 percent between 1985 and 1990 has seemed to many analysts a remarkably small return for years of investment in sometimes frantic trade negotiations and dramatic exchange rate adjustments.

The 1985-90 trend, however, appears to understate the improvement. Since U.S. exports to Japan in 1985 were slightly more than one-third the level of imports, closing the gap would have required exports to grow nearly three times as fast as imports. Furthermore, the yen's appreciation between 1985 and 1990 worked against any improvement to the extent that Japanese producers raised dollar-denominated prices to recover yen-based costs, thereby boosting the dollar value of Japan's outbound shipments. Seen in this context, the modest reduction in the dollar-denominated bilateral trade imbalance masked a substantial reversal of previous trends.

In the realm of trade negotiations, too, deficits are not necessarily a key motivator, even if negotiators sometimes act as if they believe otherwise. Consider the statement of Linn Williams, a deputy U.S. trade representative, to a congressional committee this spring:

> The issue for trade policy, however, is market access, not trade deficits. Trade deficits are caused primarily by macroeconomic factors, such as exchange rates and savings

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> rates. (Bilateral deficits are also unreliable indicators of trade policy, because they reflect only trade between two countries not among all countries.) For the trade deficit (overall or bilateral) to improve substantially, our savings rate must increase substantially.[1]

Mr. Williams' boss, Carla Hills, has made similar statments. For example, she responded to a question from Rep. Sam Gibbons (D, Fla.) on the cause of the U.S. trade imbalance by saying that macroeconomic factors have an "overwhelming influence on the health of our trading" and on the trade deficit.[2]

Either because they now agree that the bilateral imbalance is an inappropriate target or because they suspect its recent decline means that it is becoming less of a problem, those who call for a more activist trade policy vis-a-vis Japan appear to have realigned attention to the composition of U.S.-Japan trade. This view contends that, although Japan is importing more from the United States, the increased imports are the wrong products, at least from the U.S. perspective. Those who take this position frequently frame the U.S. economic output and export picture in terms of potato chips versus computer chips. (All but very young children, the densest economists and potato chip manufacturers are supposed to see the inherent advantages in producing computer chips, a low-profit, commodity-like product, rather than a brand-name, profitable product like potato chips.)

Kevin Kearns, formerly with the Department of State and now with the privately funded Economic Strategy Institute, appeared this spring before the same Senate subcommittee as Mr. Williams to repeat his call for a "Team B" to reevaluate U.S. economic policy toward Japan. (The expression "Team B" is borrowed from that of a group at the Central Intelligence Agency during the 1970s, when George Bush headed the agency; the group reassessed U.S. policy toward the Soviet Union.) After suggesting that broad statistical measures do not describe the full extent of the problem as he sees it, Mr. Kearns added,

> Yet even within the trade figures there are disturbing trends that administration officials apparently do not understand. At first glance, the new numbers [on U.S.-Japan trade] seem to indicate that Japan is opening its protected market and that American industry is meeting the Japanese challenge. But first glances are deceiving. The "how much" of the bilateral deficit no longer tells the whole story. Just as important is the composition of U.S.-Japan trade -- i.e. <u>what</u> is being traded and <u>where</u> in the global Japan production base it comes from.[3]

[1]Written statement of Linn Williams before Senate Governmental Affairs Committee, Subcommittee on Oversight of Government Management, May 8, 1991, p. 2.

[2]<u>National Trade Policy Agenda: Hearings Before the Subcommittee on Trade of the Committee on Ways and Means</u>, 101st Congress, 1st Session, February 28, 1989 (Washington, D.C.: Government Printing Office, 1989), p. 51.

[3]Written statement of Kevin L. Kearns before Senate Governmental Affairs Committee, Subcommittee on Oversight of Government Management, May 8, 1991, p. 6.

Does Japan Underimport?

The transfiguration of the "Japan problem" as encapsulated in Mr. Kearns' testimony has elements of an academic controversy that has simmered for years over Japan's trade structure. One description of this issue suggests that if Japan's import structure is out of whack, the cause is not excessive levels of so-called low value-added goods but an insufficient flow of high value-added products. Hence, this suggests that the potential problem is of Japan as an underimporter. Researchers have attempted to discover if Japan underimports and, if so, what policies or economic structures are responsible.

Traditional economic theory holds that, to achieve the highest economic status for itself, a country should export those products it is relatively good at producing and import those that it is relatively poor at making, provided that each can be traded easily. The theory adds that, if nations do not throw up roadblocks to such activities, profit-maximizing firms and consumers seeking the highest quality at the best price will induce this result automatically among countries with market economies. Hence, a nation that imposes high tariffs and/or quotas or otherwise restricts imports is doubly culpable, according to this theory: it denies the benefits of free trade not only to its own people and firms but to its trading partners as well. The effect of imposing barriers is to reduce the level of trade. Therefore, a nation with such restrictions can be considered an "underimporter."

Virtually no nation, including the United States, is totally innocent of erecting trade barriers. However, Japan's have attracted particular attention. For decades businessmen have complained about the difficulties of penetrating the Japanese market; a small library of books exists giving chapter and verse to their arguments. Measuring the net impact of those barriers is another, more difficult, matter. However, Gary Saxonhouse of the University of Michigan, in research efforts that span years, has come to a uniform conclusion: factor endowments, such as abundant labor or its absence, adequately explain trade patterns and there is no obvious need to include Japanese trade policies as a factor. As Mr. Saxonhouse puts it, ". . . [T]his suggests that whatever Japanese (and American) trade policies and/or informal barriers may have been, more than likely they have not been a major determinant of trade patterns."[4]

Mr. Saxonhouse's conclusion has not gone unchallenged, either in the academic community or elsewhere. Beyond the anecdotal evidence of Japanese barriers is the undeniable fact that Japanese imports of manufactured goods are low compared to other industrial countries.[5] While a casual observer might argue that Japan could be expected to import relatively little of what it obviously is extremely good at producing itself, many experts note that industrial nations typically import large quantities of goods only slightly different from those they themselves produce and sometimes export. The United States, for

[4]Gary R. Saxonhouse, "Differentiated Products, Economies of Scale and Access to the Japanese Market," in Robert C. Feenstra (ed.), Trade Policies For International Competitiveness (Chicago, Illinois: National Bureau of Economic Research, 1989), p. 167.

[5]See JEI Report No. 14A, April 8, 1988, and Edward J. Lincoln, Japan's Unequal Trade (Washington, D.C.: Brookings Institution, 1990), pp. 39-60.

example, is both an exporter and an importer of manufactured food products; some Americans have a taste for exotic biscuits, for example, while some foreigners apparently have a craving for American fare. This kind of commerce, known as intra-industry trade, typically characterizes modern industrial economies.

Because Japan imports comparatively few manufactured goods and presumably is not an overimporter of other goods, the intra-industry trade argument leads to the conclusion that Japan is an underimporter overall. While Mr. Saxonhouse's conclusion suggests that the low level of Japanese manufactured imports has explanations rooted in factor endowments (meaning, thereby, Japan is not an underimporter), Robert Lawrence of the Brookings Institution disagrees, at least to a degree. In a 1987 study he concluded:

> [I]n 1980, for example, as equations in this study indicate, unusual barriers and preferences reduced Japanese manufactured goods imports about 40 percent. The removal of such barriers would have increased the value of Japanese manufactured imports about $13 billion and lowered Japan's trade surplus in manufactured goods about $16 billion, or some 17 percent. Japan would have had considerably more intra-industry trade.[6]

In addition to Messrs. Lawrence and Saxonhouse, other researchers have taken a crack at the question in recent years, with differing results.[7] In addition, a number of experts have volunteered themselves as referees to this scholarly squabble. After quoting T.N. Srinivasan and Koichi Hamada of Yale University in their evaluation of the works by Messrs. Saxonhouse, Lawrence and others, Jagdish Bhagwati of Columbia University added his own observations and concluded, "The case that Japan's imports, whether total or of manufactures, are abnormally low, when set against predictions by international trade economists of what they should be, is thus seriously weak, and the best-crafted research militates against it."[8]

If Japan Underimports, What Factors Are Responsible?

The comments of Messrs. Srinivasan, Hamada and Bhagwati, while influential, have not silenced those who still believe that Japanese policies or practices are the cause of Japan's distinctive pattern of trade, particularly in manufactured imports. Mr. Lawrence, for one, is undeterred and, in fact, has built on his earlier work, which left open important questions of causality.

At least two explanations of low manufactured goods imports would indicate Japan has few options that it could pursue to increase their level. First,

[6]Robert Z. Lawrence, "Imports in Japan: Closed Markets or Minds?" Brookings Papers on Economic Activity, 1987, No. 2, p. 546.

[7]For a summary of these efforts and some criticism of each, see Kenji Takeuchi, "Does Japan Import Less Than It Should? A Review of the Econometric Literature," Asian Economic Journal, III, September 1989, pp. 138-170.

[8]Jagdish Bhagwati, The World Trading System at Risk (Princeton, New Jersey: Princeton University Press, 1991), p. 37.

as Mr. Bhagwati and others have pointed out, if Japan is an underimporter, the cause could be the export restrictions that it faces.[9] This apparently outrageous statement deserves an explanation. In response to quotas or other restrictions on Japanese exports, the demand from abroad for yen would be lower than otherwise, causing the Japanese currency to depreciate; that, in turn, would make Japanese imports more expensive. The demand for imported manufactured goods could drop sharply in contrast to raw materials, whose demand is fairly unresponsive to price changes. Hence, export restrictions could lead fairly directly to low levels of manufactured imports in addition to lower-than-otherwise levels of manufactured exports.

Second, a low volume of manufactured goods imports could be a result of more homogeneous tastes in Japan than in North America and Europe. As noted in the example of food products above, intra-industry trade arises in part because some consumers may prefer an imported version of a product that is made efficiently at home. If domestic tastes are homogeneous, local producers can turn out the desired product in large, efficient quantities, reducing the need for intra-industry trade in a good in which the country has comparative advantage.

Mr. Lawrence's research strategy has been to identify less benign alternative explanations of Japan's intra-industry trade and test for their significance. He finds a leading candidate in Japan's distinctive pattern of importation. In contrast to the leading role played by Japanese exporters in selling their goods in the American market, Japanese imports from the United States are likely to be handled by Japanese companies. This difference matters to Mr. Lawrence, who describes evidence that such firms mark up the prices charged in the Japanese market significantly more than their counterpart firms do in other markets. As Mr. Lawrence recently noted in testimony before a Senate subcommittee, "Foreign firms play a remarkably small role in selling their products in Japan, and the evidence below indicates they are paid only world market prices. Most of the unusually high prices for foreign products are due to Japanese distributors. Thus the beneficiaries of increased competition in the Japanese distribution system would be Japanese consumers and American exporters."[10] From this statement one easily concludes that, if Mr. Lawrence's research is correct, manufactured imports in Japan are low in part because they are overpriced by their (Japanese) importers.

Mr. Saxonhouse has challenged these arguments in a comment for a forthcoming book where an article by Mr. Lawrence also is to appear. Among other objections, the University of Michigan professor finds that the predominance of Japanese firms involved in imports stems largely from the fairly unimportant question as to where a firm takes title to an import (in the country of origin or of importation). In addition, he suggests that the high prices charged in Japan for American products could be the result of high-price, low-volume strategies developed by U.S. firms.[11]

[9] Ibid., pp. 36-39.

[10] Written statement of Robert Z. Lawrence before Senate Committee on Finance, Subcommittee on International Trade, April 15, 1991, p. 7.

[11] See Robert Z. Lawrence, "How Open is Japan," and Gary R. Saxonhouse, "How Open is Japan: Comment," in Paul Krugman (ed.), The U.S. and Japan: Trade and Investment (Chicago, Illinois: University of Chicago Press, forthcoming).

Mr. Lawrence recently has taken his argument yet another step, identifying Japan's low level of manufactured goods with another widely observed characteristic of the Japanese economy: keiretsu. (Keiretsu are described in JEI Report No. 2A, January 12, 1990.) His statistical tests appear to show that imports are particularly low in those sectors where keiretsu-related firms account for a comparatively large share of output, other factors equal. He finds, for example, that the effect of keiretsu in one of several equations he estimates -- absent exchange rate changes -- is to reduce the level of imports by more than 50 percent. Conversely, magically removing keiretsu would increase imports significantly, other factors equal, he suggests. As he acknowledges, however, the yen would depreciate in this situation, reducing the overall impact.[12]

Not surprisingly, Mr. Saxonhouse has challenged Mr. Lawrence's keiretsu study.[13] Many of his objections are related to the way in which Mr. Lawrence set up equations to relate the prevalence of keiretsu to import shares; taking account of many, if not all, of the problems Mr. Saxonhouse identifies would reduce the measured impact of keiretsu on import structure. Any downscaling of Mr. Lawrence's results would put his overall conclusion in serious jeopardy since the econometric confidence levels and the degree to which, even in total, Mr. Lawrence's equations explain import behavior are far from overwhelming. For example, the most successful of Mr. Lawrence's equations in explaining import shares explains only 45 percent of the variation among sectors even when keiretsu and eight other factors are included. This raises the real possibility that excluded factors may swamp the influence of the keiretsu component.

Another example of the fragility of Mr. Lawrence's results is the effect of the aircraft industry on his conclusions. Import shares are very large and the small domestic industry is dominated by keiretsu. In other words, this industry is an exception to the apparent relationship between keiretsu and imports. Mr. Lawrence chooses to exclude it from his equations but reports that, if the aircraft industry were included, the negative relationship between import shares and keiretsu would weaken significantly. In justifying the exclusion, he correctly notes that the industry is unusual in many ways. However, while some of the industry's unique characteristics arguably work to increase imports above predicted levels, other attributes could have the opposite effect. (For details concerning Japan's aircraft industry see JEI Report No. 34A, September 1, 1989). In short, since the case for excluding aircraft is not unambiguous, Mr. Lawrence's results are put in further jeopardy.

In summary, Mr. Lawrence's keiretsu study, like his earlier efforts, has its share of critics. In addition, the premise on which the keiretsu study is

[12]Robert Z. Lawrence, "Efficient or Exclusionist? The Import Behavior of Japanese Corporate Groups," Brookings Papers on Economic Activity, 1991, No. 1, forthcoming. Mr. Lawrence summarized his argument in less technical language in the above-cited statement before Finance's trade subcommittee.

[13]Gary R. Saxonhouse, "Efficient or Exclusionist? The Import Behavior of Japanese Corporate Groups: Comments and Discussion," Brookings Papers on Economic Activity, 1991, No. 1, forthcoming.

based -- that Japan is an underimporter -- is inconsistent with other important academic research. If, indeed, Japan is not an underimporter, then the keiretsu study loses much of its relevance.

Public Reaction and the Effect on SII

These caveats notwithstanding, Mr. Lawrence's work on keiretsu began attracting enormous attention in Washington and Tokyo even before its formal publication. For example, in an April Washington Post article deputy USTR Williams described Mr. Lawrence's work as "quite significant." David Hale, a widely quoted economist with Kemper Financial Services, said the results were "as close as you can get with these things to a smoking gun." Others, including two of Japan's best-known economists, were quoted as being critical.[14]

Coming as it did less than a month before the release of the first annual report on implementation of the pledges Tokyo and Washington made during the Structural Impediments Initiative discussions, in which Mr. Williams played a leading role, Mr. Lawrence's research -- and the subsequent publicity -- may well have had an impact on the May meeting to draft the assessment. In the context of SII, Washington would like Tokyo to put more emphasis on enforcing the Antimonopoly Law, adopting measures that would strengthen the law and monitoring keiretsu transactions more closely. While conceding that Japan has taken steps in these directions, the U.S. delegation's report added:

> Beyond these measures, the GOJ [government of Japan] has not appreciably furthered the agreed goals of the SII process in the keiretsu area. In particular, other measures to make keiretsu more open and transparent have been lacking. . . . The keiretsu system remains a formidable barrier to entry into the Japanese market.

The U.S. delegation also wrote that it had not seen evidence of increased monitoring by Japan's Fair Trade Commission of keiretsu transactions, another pledge that Washington felt Tokyo had made in the SII talks.[15]

Washington conceded, though, that Tokyo has taken some steps in recent months to prevent abuses of market power in Japan. If, as Washington charges, Tokyo is reluctant to do more, the reason could be that Japanese officials see limited anticompetitive effects arising out of keiretsu behavior and, perhaps, even some benefits in terms of increased efficiency.

Effect on U.S.-Japan Trade Flows

Despite considerable academic skepticism, Mr. Lawrence's work clearly has had an influence. Japanese policy -- with considerable U.S. prodding -- may move further in the direction that Mr. Lawrence's research seems to suggest

[14]Paul Blustein, "A New Study Fuels the Clash Over Keiretsu," Washington Post, April 26, 1991, p. F1.

[15]"Comments of the U.S. Delegation on the First Annual Report by the Japanese Delegation" in First Annual Report of the U.S.-Japan Working Group on the Structural Impediments Initiative (May 22, 1991), pp. 115-116.

would be desirable. If he is right that the effect of keiretsu is to impede imports, then many U.S. firms would find the Japanese market more attractive if whatever the keiretsu firms are doing to impede access could be minimized. In short, the effect would be similar to that of lowering a tariff. If so, would the U.S.-Japan trade imbalance improve? An indirect answer can be found in a Brookings article using data from the years 1981 to 1986, when Japan's surplus with the United States rose from $13.3 billion to $51.4 billion. In the article Mr. Lawrence and coauthor Robert Litan, also of Brookings, commented: "Although Japan continues to be singled out as having the most unfair trading practices of all U.S. trading partners, it is doubtful that such policies have been a major cause of the dramatic increase in Japan's trade surplus with the United States since 1981."[16]

This argument has an obvious corollary: if trading practices had relatively little to do with the rise of the bilateral imbalance, they have at most a limited role in reducing it. This conclusion meshes neatly with the earlier statement by USTR's Williams about the irrelevance of trade policy to the bilateral deficit.

It follows, then, that the questions of Japan as an underimporter or its recent variant, the effect of keiretsu on imports, boil down to the issue mentioned earlier: the composition of trade. Conceivably, if Mr. Lawrence is correct, reducing keiretsu influence could remove barriers to imports of manufactured products. The effect would be an increase in U.S. exports, presumably including sophisticated products. A secondary effect would be yen depreciation, which would offset part of the increase in U.S. exports and also lift American imports of Japanese goods. In short, the net effect would be an increase in trade in both directions, with an ambiguous impact on the bilateral imbalance. American consumers and businesses -- and quite likely their Japanese counterparts -- would be better off from being able to use the world's resources more efficiently. The stronger dollar would be the obvious manifestation of this development for the United States; Americans would have to give up less to obtain any given amount of imports. Exporters to the United States and elsewhere as well as purchasers of the products from which barriers are removed would be the most obvious beneficiaries in Japan.

Lower Japanese barriers leading to higher U.S. sales of manufactured goods also would create losers in the United States. The cheaper yen that would be one result of such changes would imply that those companies that compete with Japanese exports would have a harder time. For the same reason, those firms that already compete successfully in Japan probably would see their sales fall. As noted above, traditional economic theory would suggest that the American winners would outnumber the losers. This conclusion is even more likely if American manufacturers with substantial market power were newly able to extract high profits from the Japanese market. Finally, to the extent that the higher exports contained a substantial high technology component, American firms and consumers not directly affected still could benefit if technology development and diffusion proceeded more rapidly than otherwise.

[16]Robert Z. Lawrence and Robert E. Litan, "The Protectionist Prescription: Errors in Diagnosis and Cure," Brookings Papers on Economic Activity, 1987, No. 1, p. 294.

Recent evidence suggests that the composition of Japan's imports -- in particular those from the United States -- is moving toward a greater proportion of manufactured goods. As shown in Table 1, manufactured goods as a percentage of total imports more than doubled during the 1980s, climbing from 22.8 percent to 50.3 percent in both 1989 and 1990. Some economists like Rudiger Dornbusch of the Massachusetts Institute of Technology have argued that such figures mean little if manufactured imports as a share of gross national product are nonetheless constant or declining.[17] Although the ratio of manufactured to total imports started rising at the beginning of the decade, manufactured goods maintained a fairly constant share of GNP until a two-year low in 1986 and 1987. Since then, however, the ratio has risen sharply. In sum, manufactured imports had a significantly larger share of GNP in 1990 than they did in 1980 and double the 2 percent figure that Mr. Dornbusch suggested was virtually a historical constant.

Table 1: Japan's Manufactured Imports, 1980-90

(in millions of dollars, c.i.f value)

	Manufactured Imports	Change in Volume	Share of Total Imports	Share of GNP	U.S. Share of Manufactured Imports
1980	$32,110	-2.5%	22.8%	3.0%	33.5%
1981	34,778	12.5	24.3	3.0	33.0
1982	32,827	0.6	24.9	3.0	34.9
1983	34,361	2.5	27.2	2.9	36.0
1984	40,614	20.2	29.8	3.2	34.4
1985	40,157	1.8	31.0	3.0	35.5
1986	52,781	22.6	41.8	2.6	33.4
1987	65,961	12.5	44.1	2.7	26.8
1988	91,838	30.5	49.0	3.1	25.6
1989	106,111	12.3	50.3	3.7	26.5
1990	118,028	10.3	50.3	4.0*	27.5

*Preliminary

Source: Calculated from data provided by Ministry of Finance, Ministry of International Trade and Industry and Economic Planning Agency

Table 1 also shows that the position of the United States vis-a-vis other exporters of manufactured goods to Japan has undergone some erosion. The composition of Japanese purchases from the United States, however, has mirrored that of Japanese trade overall in showing manufactured products growing faster than total purchases (Table 2). The expansion of manufactured imports generally has outpaced the growth of other imports from the United States since at least 1980, resulting in an increased percentage of U.S. exports to Japan accounted for by manufactured goods.

[17]See, for example, Rudiger Dornbusch, "Give Japan a Target and Say 'Import'," The New York Times, September 24, 1989.

Table 2: Japan's Imports from the United States, 1980-90*

	Rate of Change		Manufactured Imports as Share of Total
	All Imports	Manufactured Imports	
1980	19.5%	24.5%	44.0%
1981	3.6	6.7	45.3
1982	-4.4	-0.1	47.4
1983	1.9	7.9	50.2
1984	9.0	12.9	52.0
1985	-4.0	1.9	55.2
1986	12.6	23.9	60.7
1987	8.4	0.2	56.1
1988	33.5	33.2	56.0
1989	14.8	19.5	58.3
1990	8.5	15.5	62.0

*Imports in dollars, c.i.f. value.

Source: Ministry of Finance

Some analysts have made much of the fact that the bilateral imbalance in some manufactured goods has risen despite the decline in the overall imbalance.[18] Indeed, even the overall imbalance in manufactured goods has risen in recent years. This result is easily reconciled with the data in Table 2, however. Japanese exports of manufactured goods to the United States were, and are, much larger than the equivalent U.S. exports to Japan; in 1985, for example, the ratio was about 4.5 to 1, according to data from the Ministry of Finance. With this disparity in size the same rates of growth of each country's manufactured exports would result in an even larger absolute difference in the two figures; that is, Japan's surplus in manufactured goods would expand. To even retain the above imbalance U.S. exports would have to grow 4.5 times as fast as Japan's. While Japan-bound manufactured goods have increased far faster than comparable shipments from Japan, the disparity was not enough to prevent the bilateral imbalance in manufactured goods from widening between 1985 and 1990. By 1990, however, Japan's shipments of manufactures to the United States had dropped to 2.8 times the movement in the other direction. In short, the dollar value of the imbalance in manufactured goods rose between 1985 and 1990, but U.S. exports to Japan as a percentage of U.S. imports from Japan moved closer to balance, although, even in percentage terms, the imbalance remained extremely large.

Finally, Table 3 shows that Japan's manufactured imports increasingly are made up of products classified as sophisticated, although a definitive assessment is difficult since the categorization of a product as sophisticated is subjective. Such products as textiles and apparel, which often are regarded as embodying low technology, reduced their import share somewhat because of relatively slow growth. However, the share of machinery and transportation equipment, of which many types are widely thought to fall into the high technology category, grew substantially over the 1988-90 period.

[18]See, for example, Kearns, op. cit., pp. 6-7.

Table 3: Composition of Japan's Imports of Manufactured Goods, 1987-90

	1987	1988	1989	1990
Chemicals	18.0%	16.1%	15.0%	13.6%
Organic Chemicals	5.3	5.0	4.4	3.8
Inorganic Chemicals	1.3	1.2	1.2	1.0
Dyes and Coatings	0.8	0.7	0.6	0.6
Pharmaceuticals	3.2	2.9	2.6	2.4
Perfumes and Flavoring Materials	0.2	0.2	0.2	0.2
Toilet Preparations and Detergents	0.4	0.4	0.4	0.4
Fertilizers	0.5	0.5	0.4	0.3
Explosives	0.1	0.0	0.0	0.0
Plastics	1.8	1.6	1.5	1.4
Mineral Tar and Crude Pharmaceuticals	0.7	0.6	0.8	0.6
Radioisotope Elements	1.7	1.3	1.2	1.1
Other Chemicals	2.0	1.8	1.7	1.7
Machinery and Transport Equipment	29.0	29.0	30.5	34.7
Nonelectric Machinery	10.2	10.2	10.8	11.8
Electric Machinery	9.3	10.1	10.8	10.9
Transportation Equipment	7.0	6.7	6.5	9.4
Precision Instruments	2.5	2.1	2.3	2.6
Textiles and Apparel	11.6	11.6	12.5	10.8
Metals and Fabricated Products	13.7	16.5	15.5	13.8
Steel	3.8	5.0	4.8	3.9
Nonferrous Metals	8.6	10.1	9.3	8.4
Fabricated Metal Products	1.3	1.4	1.4	1.5
Other Manufactures	19.7	19.9	21.0	22.0
Leather, Leather Products and Furs	0.4	0.3	0.3	0.3
Rubber Products	0.7	0.7	0.7	0.6
Wood Products	2.5	2.3	2.7	2.5
Paper and Paper Products	1.3	1.2	1.2	1.0
Nonmetallic Mineral Products	4.4	4.5	4.5	4.6
Miscellaneous Goods	10.4	11.0	11.6	13.0
Reimports and Commodities Not Classified by Kind	8.2	6.8	5.4	5.2
Total Manufactured Imports	100.0	100.0	100.0	100.0

Notes: Based on classification system used in White Paper on International Trade (Tokyo: Japan External Trade Organization, 1990), pp. 158-159.

Imports accounting for less than 0.05 percent of the 1989 total were reclassified from nonmetallic mineral products to textiles in 1990.

Source: Ministry of Finance

Pharmaceuticals, a high technology category by most accounts, declined in relative importance despite a 34.3 percent jump in dollar-denominated imports over the 1987-90 period. In this and a number of other product groups, the import figures do not fully reflect the success of foreign firms in Japan's markets to the extent that U.S. and other foreign companies receive substantial licensing fees from Japanese companies or produce their products in Japan.

Tables 1-3, along with the concurrent decline in Japan's trade surplus both overall and with the United States, present a remarkably consistent -- and encouraging -- picture for those concerned about the composition of Japan's trade. Import growth has outpaced export growth; manufactured imports have grown faster than purchases of industrial and agricultural inputs, and relatively sophisticated manufactured imports may well have grown fastest of all.

Implications of the Growth of Manufactures

Does the recent growth in imports of manufactured goods suggest that Mr. Lawrence's work on keiretsu is out-of-date before its formal publication? His estimates of the effect of keiretsu are based primarily on 1985 data, but they are not necessarily invalid for this reason. The keiretsu factor still may be an important influence, other factors equal. If other factors, such as the exchange rate, move up or down, the level of imports could change without affecting the power of the keiretsu factor. Robert Corker of the International Monetary Fund, however, has found evidence that the structure of Japanese imports, including manufactured goods, changed in the second half of the 1980s in ways not predictable from conventional equations. While Mr. Corker does not address the question of keiretsu, his results suggest that the influence of keiretsu on the import structure could have changed in recent years.[19] In addition, as Mr. Saxonhouse has pointed out, implementation of Tokyo's SII pledges concerning the distribution system could create more competitive markets in Japan, reducing the distortions keiretsu may or may not introduce.[20]

Rather than discovering the smoking gun in keiretsu and trade, Washington policymakers may have jumped the gun in bearing down hard on keiretsu as part of the SII process. Whether keiretsu are important or not, the data make clear that significant changes are under way in the level and, quite often, the structure of Japan's imports. U.S. suppliers, whose share of Japan's manufactured goods imports has dipped modestly in recent years, nonetheless have seen the absolute size of their Japanese market expand significantly.

[19]Robert Corker, The Changing Structure of Japanese Trade Flows (IMF Working Paper WP/90/107, November 1990).

[20]Saxonhouse (1991), op. cit.

For further information, contact Douglas Ostrom.

Patrick Trepanier provided research assistance.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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